ABC GLOSSARY

Capital Decay. 1. A quantification of the lost revenues or reduction in net cash flows sustained by an entity due to obsolete technology. 2. A measure of uncompetitiveness.

Cost Object. Any customer, product, service, contract, project, or other work unit for which a separate cost measurement is desired.

Cost of Quality. All the resources expended for appraisal costs, prevention costs, and both internal and external failure costs of activities and cost objects.

Customer Value. The difference between customer realization and sacrifice. Realization is what the customer receives, which includes product features, quality and service. This takes into account the customer's cost to use, maintain, and dispose of the product or service. Sacrifice is what the customer gives up, which includes the amount the customer pays for the product plus time and effort spent acquiring the product and learning how to use it. Maximizing customer value means maximizing the difference between realization and sacrifice.

Direct Cost. A cost that is traced directly to an activity or a cost object. For example, the material issued to a particular work order or the engineering time devoted to a specific product are direct costs to the work orders or products.

Fixed Cost. A cost element of an activity that does not vary with changes in the volume of cost drivers or activity drivers. The depreciation of a machine, for example, may be direct to a particular activity, but it is fixed with respect to changes in the number of units of the activity driver. The designation of a cost element as fixed or variable may vary depending on the time frame of the decision in question and the extent to which the volume of production, activity drivers, or cost drivers change.

Incremental Cost. 1. The cost associated with increasing the output of an activity or project above some base level. 2. The additional cost associated with selecting one economic or business alternative over another, such as the difference between working overtime or subcontracting the work. 3. The cost associated with increasing the quantity of a cost driver.

Indirect Cost. The cost that is allocated – as opposed to being traced – to an activity or a cost object. For example, the costs of supervision or heat may be allocated to an activity on the basis of direct labor hours.

Non-value-added Activity. An activity that is considered not to contribute to customer value or to the organization's needs. The designation non-value-added reflects a belief that the activity can be redesigned, reduced, or eliminated without reducing the quantity, responsiveness, or quality of the output required by the customer or the organization.

Obsolescence. A product or service that has lost its value to the customer due to change in need or technology.

Opportunity Cost. The economic value of a benefit that is sacrificed when an alternative course of action is selected.

Pareto Analysis. The identification and interpretation of significant factors using Pareto's rule that 20 percent of a set of independent variables is responsible for 80 percent of the result. Pareto analysis can be used to identify cost drivers or activity drivers that are responsible for the majority of cost incurred by ranking the cost drivers in order of value.

Performance Measures. Indicators of the work performed and the results achieved in an activity, Process, or organizational unit. Performance measures may be financial or nonfinancial. An example Of a performance measure of an activity is the number of defective parts per million. An example of a performance measure of an organizational unit is return on sales.

Process. A series of activities that are linked to perform a specific objective. For example, the assembly of a television set or the paying of a bill or claim entails several linked activities.

Project Costing. A cost system that collects information on activities and costs associated with a specific activity, project, or program.

Support Costs. Costs of activities not directly associated with production/service. Examples are the costs of process engineering and purchasing.

Tracing. The assignment of cost to an activity or a cost object using an observable measure of the consumption of resources by the activity of cost object. Tracing is generally preferred to allocation if the data exist or can be obtained at a reasonable cost. For example, if a company's cost accounting system captures the cost of supplies according to which activity uses the supplies, the costs may be traced – as opposed to allocated – to the appropriate activities.

Throughput. The rate of production of a defined process over a stated period of time. Rates may be expressed in terms of units of products, batches produced, dollar turnover, or other meaningful measurements.

Unit Cost. The cost associated with a single unit of the product, including direct costs, indirect costs, traced costs, and allocated costs.

Value-added Activity. An activity that is judged to contribute to customer value or satisfy an organizational need. The attribute "value-added" reflects a belief that the activity cannot be eliminated without reducing the quantity, responsiveness, or quality of output required by a customer or organization.

Value Analysis. A cost reduction and process improvement tool that utilizes information collected about business processes and examines various attributes of the processes (e.g., diversity, capacity, and complexity) to identify candidates for improvement efforts.

Variance. The difference between an expected and actual result.

Variable Cost. A cost element of an activity that varies with changes in volume of cost drivers and activity drivers. The cost of material handling to an activity, for example, varies according to the number of material deliveries and pickups to and from that activity.

Waste. Resources consumed by unessential or inefficient activities.

Willie Sutton Rule. Focus on the high-cost activities. The rule is named after bank robber Willie Sutton, who – when asked "why do you rob banks?" – is reputed to have replied "because that's where the money is."